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Protecting "Evil Zombie Standing" in Federal Court:
How NAFER is Helping Receivers to Recover from Wrongdoers

By David A. Castleman and Varinder P. Singh

No legal issue is more important to federal equity receivers than their ability to recover money on behalf of injured consumers or investors.

In recent years, however, defendants have challenged the standing of receivers to pursue wrongdoers who participated in the fraudulent schemes. The defendants have asserted that a receiver could not pursue claims against them because the receiver represented the same companies that had concocted or enabled the fraud in the first place. For support, they relied on the old common law doctrine of *in pari delicto* (in "equal fault"), which generally prohibits one wrongdoer from suing another.

The seminal case on the subject is Judge Richard Posner's 1995 opinion in *Scholes v. Lehmann*, which held that once receivers take over a company, they are "cleansed" of the "evil zombies" created by the fraudsters and have standing to pursue fraudulent transfer claims against the alleged perpetrators.[1] Readers of this publication will be familiar with this issue. Daniel Seligman explained the origins and the contours of the doctrine in his June 2023 article *In Pari Delicto and Evil Zombies*.[2] In a February 2013 article entitled *Receivers and the In Pari Delicto Doctrine*, in the very first issue of *The Receiver*, NAFER's current president-elect Kathy Bazoian Phelps detailed both the doctrine and the exceptions potentially available to receivers in pursuing their claims.[3]

Even though the Evil Zombie doctrine set forth in *Scholes* is well-established law, one district court in Florida in 2022 dismissed the receiver's fraudulent transfer and related tort claims, forcing the receiver to appeal. And even when receivers win blockbuster verdicts, as was recently accomplished in Minnesota by Douglas Kelley as receiver and discussed *infra*, that victory must still withstand appellate review. These recent attacks on Evil Zombie standing threaten to undermine the work of receivers all over the country.

NAFER's Role

In recent months, NAFER has played a key role in attempting to protect the Evil Zombie doctrine. In March 2024, the U.S. Court of Appeals for the Eleventh Circuit decided *Wiand v. ATC Brokers Ltd.* ("*ATC*"),[4] a case brought by Burton Wiand as receiver and argued by Jared Perez (both NAFER members), alleging claims for fraudulent transfer and aiding and abetting fraud against a third party. NAFER, represented by Michael Goldberg and Michael Napoli of Akerman LLP, filed an amicus

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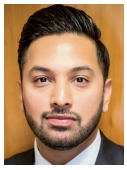

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brief in support of Wiand's position.[5] The Eleventh Circuit ruled in favor of Wiand's standing as receiver to bring fraudulent transfer causes of action, citing specifically to the "Evil Zombie Standing" ruling under the *Scholes* case.[6]

Meanwhile, the U.S. Court of Appeals for the Eighth Circuit held oral argument in May 2024 in *Kelley v. BMO Harris Bank N.A.*,[7] a case that also involves the *in pari delicto* defense. In that case, Douglas Kelley as receiver and bankruptcy trustee of the Petters Ponzi scheme (represented by NAFER members Michael Collyard and Peter Ihrig from Robins Kaplan LLP) alleged that BMO Harris Bank aided and abetted the Petters' fraud. The receiver won a jury verdict of over $1 billion including prejudgment interest. NAFER filed an amicus brief in December 2023, represented by the authors and their colleague at Otterbourg, former bankruptcy judge Melanie Cyganowski, explaining why Evil Zombie Standing should cleanse receivers of the *in pari delicto* defense.

Wiand v. ATC Brokers: The Eleventh Circuit Decision

The *ATC* case arose out of the alleged Oasis Ponzi scheme that collapsed in 2019, when the Commodity Futures Trading Commission ("CFTC") initiated a regulatory action and requested that the district court in Florida appoint Wiand as receiver. Wiand filed a complaint against ATC Brokers Ltd. ("ATC Brokers"), alleging they received approximately $22 million in fraudulent transfers. The district court, however, dismissed with prejudice Wiand's claims against ATC Brokers on the ground that he lacked standing due to the *in pari delicto* defense. The court did not differentiate between the fraudulent transfer and tort claims.[8] Wiand appealed, arguing that established Eleventh Circuit and Florida law recognize a receiver's ability to pursue claims against recipients of a fraudulent transfer under the Florida Uniform Fraudulent Transfer Act ("FUFTA").

In March 2023, NAFER filed an *amicus curiae* brief with the Eleventh Circuit in support of Wiand. In its brief, NAFER emphasized the importance of federal equity receivers in managing entities, marshaling assets, and distributing funds to creditors in the aftermath of fraudulent schemes, and explained how fraudulent transfer actions were central to that function. Relying on that portion of *Isaiah v. JPMorgan Chase Bank* that is helpful to receivers, NAFER explained how the Eleventh Circuit had already held that receivers have standing to bring fraudulent transfer claims. NAFER warned that "future fraudulent transfer defendants in nationwide receivership cases will likely attempt to improperly argue lack of standing" if the lower court decision is allowed to stand.

In March 2024, the Eleventh Circuit reversed the district court, noting that it had "adopted *Scholes* and 'evil zombie' standing," holding that receivers have standing to maintain claims against fraudulent transferees.[9] The Eleventh Circuit, relying on *Scholes*, explained that once "the perpetrators are removed and a receiver is appointed in their place, the corporate structures are no longer the 'evil zombies' of the perpetrator; they are '[f]reed from his spell' and regain standing to sue for the return of money fraudulently transferred."[10] As any receiver or trustee knows, these claims are a critical tool for ensuring that those who profited from the scheme—even innocently—are required to return those fake profits to the pool for the victims who are not likely to be getting close to 100 cents on the dollar. The Eleventh Circuit also corrected the district court's failure to distinguish between common-law tort claims and fraudulent transfer claims in its analysis of standing. This distinction may be critical for receivers to explain in future cases.

On the other hand, the Eleventh Circuit held that Wiand, as the receiver, lacked standing to maintain common-law tort claims on behalf of "a singular enterprise entirely controlled by fraudsters"[11] against third parties who allegedly participated in the scheme. The court drew heavily from its own precedent in *Isaiah*, which found that a receiver was cleansed to have standing to bring fraudulent transfer claims but not to have standing to bring common-law tort claims.[12] In an unusual development, the entire panel, including Chief Judge William Pryor, signed onto a separate concurring opinion, questioning the precedent set in *Isaiah* for failing to distinguish between the receiver's *standing* to bring a claim—a jurisdictional issue—and whether the receiver was able to *state* a claim under Florida law. The concurrence argued that any impediment to bringing the common-law fraud claims was not a jurisdictional Evil Zombie Standing issue but was rather based on substantive Florida law.[13] A future case in the Eleventh Circuit where a receiver decides to bring a common-law claim otherwise permissible under state law could, in the right circumstances, be a potential vehicle for *en banc* review of *Isaiah*, given the signal sent by the three-judge concurrence.

Kelley v. BMO Harris Bank: Argument Overview

The infamous Petters Ponzi scheme, which is still being litigated after sixteen years, continues to raise issues of paramount importance to federal receivers, including at the federal appellate level. In October 2008, Tom Petters was arrested and his business Petters Companies Inc. ("PCI") was exposed as a multi-billion-dollar fraud that lasted over a decade. Douglas Kelley was appointed receiver over PCI in the criminal case, and he filed for bankruptcy shortly thereafter. PCI-related litigation continued for years, including fraudulent transfer actions that the receiver had standing to bring.[14] In one case, Kelley brought an action against BMO Harris Bank ("BMO") alleging that it had aided and abetted a breach of fiduciary duty. After years of pre-trial motion practice in which the bankruptcy and district courts held that Kelley's claims could be brought, a month-long trial featuring 23 witnesses and over 250 exhibits was held in October 2022. A jury found BMO liable and awarded over $484 million in damages plus nearly $80 million in punitive damages. After post-trial motions confirmed the verdict and the calculation of pre-judgment interest, the judgment had swelled to over $1 billion.

BMO appealed to the Eighth Circuit, contesting liability, damages, and an adverse inference instruction based on a finding that BMO intentionally destroyed substantial amounts of relevant evidence. Each of those arguments received a detailed response by Kelley in his briefing.[15] BMO appealed on an additional ground and threshold issue—that Kelley was barred from bringing the aiding and abetting claims based on the *in pari delicto* equitable defense because PCI's fraudulent conduct should be imputed to Kelley. BMO was supported in its effort by the Bank Policy Institute, Securities Industry and Financial Markets Association (SIFMA), and the U.S. Chamber of Commerce jointly as *amici curiae* (the "Bank Amici"), who argued that the failure to apply *in pari delicto* to Kelley and

similarly situated individuals was particularly harmful to banks.[16]

Kelley filed an appellate brief refuting BMO's arguments, explaining in detail why Minnesota law cleansed receivers of their standing to bring these claims, and why Kelley, as liquidating trustee, continued to be cleansed after the bankruptcy filing.[17] NAFER, represented by the authors of this article, filed an amicus brief, explaining why resolution of this issue in favor of Kelley is important to the entire receivership community. Citing the Evil Zombie Standing principle in *Scholes*, NAFER explained that "the receivership entity is cleansed from the control of its former principals, the entire basis of *in pari delicto* falls away as the victims—not the wrongdoer—are the ones who benefit from any recovery. Giving an otherwise culpable defendant a get-out-of-liability-free card serves no purpose other than to harm innocent creditors and victims, reducing their recovery."[18]

On May 9, the Eighth Circuit held oral argument, the audio of which is available online.[19] Two former solicitor generals argued the case—Donald Verrilli for BMO (2011-2016) and Paul Clement for Kelley (2004-2008). BMO argued that *in pari delicto* was only waived when a receiver asserted the rights of creditors, and that bankruptcy trustees should not be advantaged because there was a pre-bankruptcy receivership. Kelley explained how Minnesota law cleanses the receiver of *in pari delicto*, and highlighted the point—also made in NAFER's brief—that one "cannot just push a button and get a receiver," recognizing the critical role of the Court in appointing and supervising federal equity receivers. A decision is expected later this year.

Conclusion

In both these cases, NAFER's Amicus Committee reviewed the district court decisions and fully supported the writing of an amicus brief, which was then approved by the NAFER board. NAFER's briefs in both *ATC* and *BMO Harris* demonstrate its commitment to assisting its members in recovering money for injured investors, consumers and other parties.

The authors would like to thank Daniel Seligman for his careful and insightful comments and revisions to this article.

Recent Appellate Developments in Receivership Law

Update by David Castleman, Amicus Committee Co-Chair

Just before publication of *The Receiver* was finalized, both the Fourth Circuit and the Fifth Circuit announced published decisions that may be relevant to NAFER members practicing in this space. One of these decisions concerned a rising tide distribution plan, and the other a worldwide bar order. Both are summarized as follows:

Rising Tide Distribution Plan: *CCWB Asset Investments v. Milligan*, Case No. 22-2256, --- F.4th ----, 2024 WL 3658780 (4th Cir. Aug. 6, 2024). The Fourth Circuit recently upheld, in a published decision, the use of a "rising tide" distribution plan for a receivership over a "consumer debt portfolio" Ponzi scheme in a case brought by the SEC. The distribution plan proposed by Court-appointed receiver Greg Milligan (a NAFER member) used the rising tide method, under which a receiver deducts pre-receivership withdrawals and distributions (unless rolled over). It also contained a collateral offset provision to account for recoveries from other sources. After finding that it had appellate jurisdiction to review the receiver's plan under the collateral order doctrine, the Fourth Circuit reviewed for abuse of discretion and found that a rising tide plan proposed by the receiver was well within the district court's discretion to approve when funds were limited and hard choices must be made. A further aspect of the Court's ruling may be relevant to receivers facing difficult choices on how to expend estate resources, as the Court also found that the receiver was not obliged to undertake costly and administratively difficult calculations in order to trace the origin of funds for each investor's reinvestment.

Bar Orders, *In Rem* and *In Personam* Jurisdiction: *SEC v. Stanford Int'l Bank, Ltd.*, Case No. 23-10726, --- F.4th ----, 2024 WL 3738048 (5th Cir. Aug. 9, 2024). In the latest published decision from the Fifth Circuit in the Stanford Ponzi scheme, the Court considered whether the district court had *in rem* jurisdiction to enter a worldwide bar order to enjoin Stanford-related claims against a settling bank, and whether the district court had *in personam* jurisdiction over the specific objector. The Court first held that, while in rem jurisdiction can consider all claims against the *res* (property) at issue, "injunctions bind people, not property, so *all* injunctions require *in personam* jurisdiction." The Court rejected the receiver's arguments that "receivership injunctions are somehow exempt from the rules that apply to every other federal injunction" and that there was such a thing as an *in rem* injunction. Turning to the *in personam* jurisdiction over the specific objector at issue, the Court refused to allow, as coercive, the objector to be placed into a "so-called waiver trap," that would effectively place the objector "on the horns of a waive-or-forfeit dilemma" of whether to waive personal jurisdiction objections or to forfeit merits objections.

Both these decisions are available on Westlaw, and for no cost on the websites of the Fourth Circuit (https://www.ca4.uscourts.gov/) and the Fifth Circuit (https://www.ca5.uscourts.gov/), under the "Opinions" section.

ENDNOTES

1 *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995) ("*Scholes*").

2 Daniel Seligman, *In Pari Delicto and Evil Zombies*, *The Receiver*, at 1 (June 2023).

3 Kathy Bazoian Phelps, *Receivers and the In Pari Delicto Doctrine*, *The Receiver*, at 6 (February 2013).

4 *Wiand v. ATC Brokers Ltd.*, 96 F.4th 1303 (11th Cir. Mar. 19, 2024).

5 Both this brief and the *Kelley v. BMO Harris Bank* amicus brief are available to members in the NAFER resource library at www.nafer.org.

6 *Wiand v. ATC Brokers Ltd.*, 96 F.4th at 1309.

7 *Kelley v. BMO Harris Bank N.A.*, No. 23-2551, Dkt. No. 5380950 (8th Cir. filed Apr. 5, 2024) (text order).

8 *Wiand v. ATC Brokers Ltd.*, No. 8:21-CV-1317, 2022 WL 19336431 (M.D. Fla. Sept. 27, 2022).

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[9] *ATC Brokers*, 96 F.4th at 1309.

[10] *Id*. at 1309 (citing *Scholes*, 56 F.3d at 754).

[11] *Id.* at 1311. Because there were no innocent directors, the entity in receivership and the scheme were considered to be coextensive. The existence of innocent stakeholders in the pre-receivership entity in other cases may result in a different outcome under Eleventh Circuit law, depending on the facts of the case.

[12] *ATC Brokers*, 96 F.4th at 1310-1311 (citing *Isaiah v. JPMorgan Chase Bank*, N.A., 960 F.3d 1296, 1301–08 (11th Cir. 2020)).

[13] *ATC Brokers*, 96 F.4th at 1312-1316 (concurring opinion of the entire panel). In the bankruptcy context, the Supreme Court recently cautioned lower courts to use more care in distinguishing between jurisdictional and non-jurisdictional reasons for dismissal. *See MOAC Mall Holdings LLC v. Transform Holdco LLC*, 598 U.S. 288, 298 (2023).

[14] *Kelley v. Kanios*, 383 F. Supp. 3d 852, 875 (D. Minn. 2019) (also detailing the facts of the PCI scheme), *rev'd and remanded sub nom. Kelley as Tr. for PCI Liquidating Tr. v. Boosalis*, 974 F.3d 884 (8th Cir. 2020). Although the Eighth Circuit reversed the district court on specific fraudulent-transfer-related issues not germane to this article, the appeals court did not question the receiver's standing to bring the claim.

[15] *Kelley v. BMO Harris Bank N.A.*, No. 23-2551, Appellant Br., Dkt. No. 5324027 (8th Cir. filed Oct. 6, 2023); *id.*, Appellee Br., Dkt. No. 5342628 (8th Cir. filed Dec. 7, 2023).

[16] *Kelley v. BMO Harris Bank N.A.*, No. 23-2551, Bank Amici Br., Dkt. No. 5326306 (8th Cir. filed Oct. 16, 2023).

[17] *Kelley v. BMO Harris Bank N.A.*, No. 23-2551, Appellee Br., Dkt. No. 5342628 (8th Cir. filed Dec. 7, 2023).

[18] *Kelley v. BMO Harris Bank N.A.*, No. 23-2551, NAFER Br., Dkt. No. 5345338 (8th Cir. filed Dec. 18, 2023).

[19] *See* http://media-oa.ca8.uscourts.gov/OAaudio/2024/5/232551.MP3.